

**TENNESSEE GENERAL ASSEMBLY
FISCAL REVIEW COMMITTEE**



FISCAL NOTE

HB 810 - SB 1235

March 2, 2009

SUMMARY OF BILL: Reduces the state sales tax rate on food and food ingredients from 5.5 percent to three percent. Levies a 25 percent sales tax on certain transactions by adult bookstores, sexually explicit businesses, escort-type businesses, and on individual charges for viewing sexually explicit movies in hotels or motels. Incrementally increases the sales tax rate on such transactions by three percent each fiscal year beginning in FY09-10, and ending in FY18-19, under specified conditions.

ESTIMATED FISCAL IMPACT:

Decrease State Revenue – Net Impact - \$179,391,500/Recurring
Forgone State Revenue – Exceeds \$10,910,100/Recurring

Increase State Expenditures – \$162,000/One-Time
Exceeds \$11,372,400/Recurring

Decrease Local Revenue - \$286,400/Recurring

Assumptions relative to sales tax on food:

- “Food and food ingredients” means substances, whether in liquid, concentrated, solid, frozen, dried, or dehydrated form, that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value.
- “Food and food ingredients” does not include alcoholic beverages, tobacco, candy, dietary supplements, or prepared food.
- According to the Department of Revenue (DOR), state sales tax revenue collected from the sale of food and food ingredients in Tennessee for FY07-08 was approximately \$504,600,000.
- Food and food ingredients were taxed at two different rates during FY07-08. The tax rate from July 1, 2007 through December 31, 2007 was six percent. On January 1, 2008 the tax rate changed to 5.5 percent as a result of Public Chapter 600 from the 2007 Public Acts. Therefore, the average tax rate for FY07-08 was 5.75 percent.

- The average tax rate calculated for FY07-08 (5.75 percent) is used to estimate total taxable food sales for FY07-08.
- Total taxable food sales for FY07-08 are estimated to be \$8,775,652,200 ($\$504,600,000 / 5.75\% = \$8,775,652,174$).
- Based on recent one-year price increases as measured by the Consumer Price Index for Food (Source: U.S. Department of Labor: Bureau of Labor Statistics), food prices are estimated to increase by at least 4.5 percent in each of the next two years.
- Taxable food sales are estimated to increase by an additional 1.25 percent in FY09-10 due to the elasticity factor resulting from the 2.50 percent tax rate reduction as proposed.
- Taxable sales for FY09-10 (adjusted for two years of growth) are estimated to be \$9,697,863,600 [$(\$8,775,652,200 \times 104.5\%) \times 105.75\% = \$9,697,863,551$].
- The decrease of state sales tax revenue is estimated to be \$242,446,600 ($\$9,697,863,600 \times 2.5\% = \$242,446,590$) in FY09-10.
- The estimated \$242,446,600 in state sales tax revenue would be apportioned as follows: \$70,369,200 to the General Fund, \$157,825,400 to the Education Fund, \$11,134,400 to local government, \$890,700 to DOR, and \$2,226,900 to the Sinking Fund.
- The net decrease to state revenue is estimated to be \$231,312,200 per year ($\$242,446,600 - \$11,134,400 \text{ local share} = \$231,312,200$).
- Local government is held harmless from the loss of state-shared sales tax revenue. As a result, the increase to recurring state expenditures is estimated to be \$11,134,400 for FY09-10. This amount will increase in subsequent years due to natural growth of taxable food sales.
- There will be additional and increasing amounts of forgone state sales tax revenue in subsequent years due to continued growth of taxable food sales. The state is expected to forgo approximately \$10,910,100 in FY10-11 [$(\$9,697,863,600 \times 104.5\%) - \$9,697,863,600 \times 2.5\% = \$10,910,097$].

Assumptions relative to adult entertainment tax:

- Based on information received from DOR for a bill introduced in 2007 containing similar language to this bill, gross revenue for the adult entertainment industry is estimated to be approximately \$12.9 billion per year.
- Based on data obtained from the U.S. Census Bureau, the population in Tennessee for 2008 was estimated to be 6,214,888; the population for the U.S. is currently estimated to be 305,919,431.
- Tennessee makes up 2.03 percent of the national population ($6,214,888 / 305,919,431 = 2.03\%$).

- Tennessee accounts for 2.03 percent (or \$261,870,000) of the adult entertainment industry's total gross revenue (\$12.9 billion x 2.03% = \$261,870,000).
- Based on information received from DOR in 2007, taxable sales occurring in Tennessee require adjustment to reflect nexus-related barriers to taxing sexually-explicit internet websites and for taxing sexually-explicit phone conversations for pay. This adjustment is estimated as a 12.5 percent reduction to taxable sales.
- Taxable sales following adjustment for nexus-related issues are estimated to be \$229,136,300 per year [$\$261,870,000 \times (100\% - 12.5\%) = \$229,136,250$].
- Given the 25 percent sales tax proposed for adult materials and entertainment, adjusted taxable sales are estimated to decrease by at least five percent.
- Taxable sales following an adjustment for a decrease in consumption of adult materials and entertainment is estimated to be \$217,679,500 per year ($\$229,136,300 \times 95\% = \$217,679,485$).
- The increase to state revenue resulting from the additional 25 percent sales tax is estimated to be \$54,419,900 per year ($\$217,679,500 \times 25\% = \$54,419,875$).
- The estimated \$54,419,900 in state sales tax revenue would be apportioned as follows: \$15,795,300 to the General Fund, \$35,425,700 to the Education Fund, \$2,499,200 to local government, \$199,900 to DOR, and \$499,800 to the Sinking Fund.
- The net increase to state revenue is estimated to be \$51,920,700 per year ($\$54,419,900 - \$2,499,200 \text{ local share} = \$51,920,700$).
- The five percent decrease in consumption of adult materials and entertainment will reduce local option sales tax revenue.
- The average local option sales tax rate is estimated to be 2.5 percent.
- The decrease to local government revenue is estimated to be \$286,400 per year [$(\$229,136,300 - \$217,679,500) \times 2.5\% = \$286,420$].

Other Assumptions:

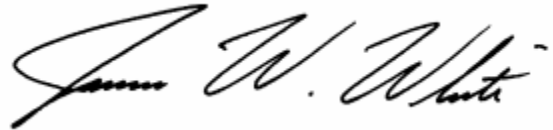
- Three additional Taxpayer Services Representatives for DOR. The associated increase to recurring state expenditures is estimated to be \$238,000 per year (\$149,400 salaries, \$73,600 benefits, \$15,000 other).
- The one-time increase to state expenditures for computer and software modifications and costs related to the three additional positions is estimated to be \$162,000.
- Increasing the adult entertainment tax by three percent per year beginning with FY09-10 and ending with FY17-18 is expected to increase state tax collections by approximately \$6,530,400 per year ($\$217,679,500 \times 3.0\% = \$6,530,385$). However, the state is expected to

forgo at least \$10,910,100 per year in sales tax collections due to continued growth of taxable food sales $\{[(\$9,697,863,600 \times 104.5\%) - \$9,697,863,600] \times 2.5\% = \$10,910,097\}$. As a result, the subsequent three percent increases would not be sufficient for offsetting forgone state revenue. Annual and escalating increases, beginning with an increase of at least five percent in FY09-10, would be required for offsetting forgone state revenue each year.

- The legislative intent of this act is that the fiscal impact of this bill be as revenue-neutral as possible. This may be accomplished with an approximate 110 percent sales tax on adult materials and entertainment as proposed, or lowering the current sales tax rate on food by approximately 0.52 percent.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

A handwritten signature in black ink, appearing to read "James W. White". The signature is fluid and cursive, with a long horizontal stroke at the end.

James W. White, Executive Director

/rnc